THE GEORGE WASHINGTON UNIVERSITY
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WASHINGTON, DISTRICT OF COLUMBIA

BUDGETS AS A CONTROL IN BUSINESS AND GOVERNMENT

For
NAVY GRADUATE COMPTROLLERSHIP COURSE

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PREFACE

This paper has been prepared for submission to Dr. A. Rex Johson, George Washington University as a term paper for the 1955 fall term of the Navy Graduate Course in Comptrollership.

Because of the time element this paper is not, nor is intended to be exhaustive; complete volumes have been written about most of the individual facets of budgeting. An attempt is merely made here to examine just how budgets are used as controls, in view of the new concept called "controllership," and to draw some comparisons between business and government.

No claim of originality is made; what thoughts are contained in this paper have been generated by the course of instruction; credit for sources of information have been given in the footnotes wherever possible.

CONTENTS

CHAPTER I

BUDGETS AND CONTROLS

Webster rather loosely defines a budget as "a financial statement of estimated income and expenses."[1] Even more loosely the term is often used to denote the cost of operations or simply the cost of living. The budget has grown in complexity as it has grown in importance, particularly as regards budgets for business and industrial enterprises; as a consequence many more comprehensive definitions have been offered by various authors.

David R. Anderson calls a budget "a summary in financial terms of the standards of performance established for all departments of a business."[2] H. H. Scaff in Financial Planning and Long Term Forecasting, says more simply that a budget is a coordinated plan for the operation of a business.[3] Bradshaw and Hull say "Properly prepared a budget is a coordinated operating plan expressed in financial terms."[4] There are a host of other definitions but none that differ essentially from those given.

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[1] A Merriam Webster, Websters New Collegiate Dictionary (New York: G. and C. Merriam Co., 1950).

[2] David R. Anderson, Practical Controllership (Chicago: Richard D. Irwin, Inc., 1949) p. 102.

[3] Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 54.

[4] T.F. Bradshaw and C.C. Hull, Controllership in Modern Management (Chicago: Richard D. Irwin, Inc., 1950), p. 45.

Budgets must be formulated and then administered. In both processes they are contributing to the desired end: control; but being inanimate, they do not control, but are only the essential tools to effect control. It would be more appropriate to say that budgets are a means of assuring that actions conform to plans. They are a device for measuring actions.[1]

Before discussing control it might be well to determine exactly what we mean by "control". Here again we find that standard dictionary definitions do not meet our requirements as is true of so many terms that have taken on special meanings. Edward Shipper says that control is an act of management--the information necessary to exercise control--must be available not only for analysis of the present and past, but for looking into the future.[2]

James L. Peirce defines control as the presence in a business of that force which guides it to a predetermined objective by means of predetermined policies and decisions.[3] This same author in another article says that control is a disciplined effort to follow a plan or explain deviations from it.[4] Arnold F. Emch defines control as the making of decisions and taking actions required by the responsibilities of each executive according to the requirements of his position.[5]

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[1]Arnold F. Emch, "Control Means Action," The Controller, August, 1955, p.

[2]Edward Shipper, "A Variable Budget Installation for Control Purposes," The Controller, August, 1955, p. 370.

[3]James L. Peirce, "The Planning and Control Concept," The Controller, September, 1954, p. 403.

[4]James L. Peirce, "The Budget Comes of Age," Harvard Business Review, May-June, 1954, p. 61.

[5]Arnold F. Emch, "Control Means Action," Harvard Business Review, July-August, 1954, p. 94.

The above definitions of control relate primarily to business and industry. Essentially budgets are controls, or instruments of control, in that they are plans of operation against which actual results can be compared, and appropriate action taken. Budgetary control, or the manner in which the budget functions as a control in government is of a rather different nature and will be discussed in Chapter III.

CHAPTER II

BUDGETS AS CONTROLS IN INDUSTRY

Budgets are sometimes confused with forecasts; they are separate entities although they have certain things in common. Actually the forecast of sales volume is the basic thing upon which the various budgets are predicated. Sales forecasts can be prepared in many ways; probably the most common is to have the sales personnel make their own predictions and modify them with the judgements of top management aided by the prediction of the company or other economists. In the words of H. H. Scaff:

> Business forecasting is the calculation of reasonable probabilities about the future, based on the analysis of all the latest relevant information by tested and logically sound statistical and econometric techniques, interpolated, modified, and applied in terms of an executives personal judgement and special knowledge of his own business.[1]

David R. Anderson, the controller of the Kendall Corporation sums up the budget preparation policy as follows:

> The budget usually starts with a forecast of sales and sales income; a plan of production is developed to meet the requirements of this sales forecast and estimates are made of the costs of the goods to be sold, the quantities and value of the inventories to be carried, and the purchases of materials, wages of labor, and other factory expenditures required to meet the production schedule. The selling and distributive expenses necessary to obtain the budgeted sales and to deliver the goods to the customers are estimated, and also the costs of administration, and the general and corporate expenses of the business. All these activities are planned

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[1]Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 57.

in relation to each other, and particularly in relation to the sales forecast, and, if the job is well and thoroughly done, the completed budget meets the definitions of "a coordinated plan for operation of the business."[1]

Allen H. Ottman lists five steps in budgetary control: (1) Forecasting, (2) Establishing the approved budgets, (3) Collecting data and reporting on actual performance, (4) Measuring any variance of actual from budgeted performance and analyzing the reasons or causes, and (5) Determining the necessary corrective action to reduce or eliminate the cause of the variance, instituting corrective action, and following up.[2]

The first two steps occur prior to any functioning of the budget as a control. The last three steps summarize briefly the actions taken in connection with budgets which constitute control. As stated by Heckert and Wilson: "once the budget is approved the business enters a new phase, the budget must be attained; the ship must be kept on course."[3] Thus the budget becomes a tool of control.

The various budgets which are used as controls in business will be briefly discussed individually. One factor must be common to all however, if they are to function effectively and that factor is flexibility. To establish a budget and attempt to adhere strictly to it in the face of sometimes radically changing conditions would be foolhardy. "The primary reason for injecting

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[1]David R. Anderson, Practical Controllership (Chicago: Richard D. Irwin, Inc., 1949) p. 10[illegible].

[2]Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 99.

[3]Heckert and Wilson, Business Budgeting and Control (New York: Ronald Press Company, 1955) p. 46.

flexibility into a budget is so that the budget may effectively serve the purpose of controlling operations."[1]

David R. Anderson has the following comment:

> Flexibility in the financial budget can be obtained by frequent revisions, or by the preparation of two or more complete alternative budgets at different levels of volume, and for some departments of the business it may be possible to construct a completely flexible budget. Thus, the budget, without pretensions to accuracy serves as a base to which executive planning and thinking can be related, and from which variations can be measured as conditions change.[2]

The same author also says:

> To secure the maximum benefit from the budget it should be used as a yardstick for the measurement of the effectiveness of the actual operations, and it should be revised often enough to be a 'live' document--that is--often enough to reflect current management planning.[3]

Some industries prepare alternate budgets for various levels of production or sales but the consensus of most authorities is that a properly prepared budget can be sufficiently flexible, and that alternate budgets are undesirable in that they tend to encourage deviation from planned performance.

A discussion of budgets as a control must include some mention of the controller, in some companies called the comptroller. A discussion of his role and responsibilities would fill a book, and when completed the book would surely be highly controversial. There are as many concepts of the controller's job as there are companies. Many companies do not even have a controller, but in

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[1]Heckert and Wilson, Business Budgeting and Control (New York: Ronald Press Company, 1955) p. 54.

[2]David R. Anderson, Practical Controllership (Chicago: Richard D. Irwin, Inc., 1949) p. 107.

[3]David R. Anderson, Practical Controllership (Chicago: Richard D. Irwin, Inc., 1949) p. 104.

any company which budgets, the function of making the budget work as a control is always carried out by someone

It is generally conceded that one function which definitely belongs to the controller is the collecting of data and reporting on actual performance. Collection of data must be done by some system of reports. "Reports are the medium of budget enforcement."[1]

James L. Peirce says:

> The hard core of reporting is comparison of actual with planned performance, in sufficient detail that every fraction of the operation, and thereby the whole, may be controlled.[2]

The details of the many budget reports will not be discussed but a representative list which might be used in a large production industrial concern is given:

Sales Budget Report
Inventory Budget Report
Cost of Production Budget Report
Orders Received and Shipments Budget Report
Factory Departmental Cost Budget Reports
Selling Expense Budget Report
Advertising Expense Budget Report
Administrative Expense Budget Report
Operating Income and Expense Budget Report
Profit and Loss Budget Report
Gain or Loss in Control Report
Capital Expense Budget Report
Cash Budget Report[3]

The reports required for any particular company will vary with the nature of the business, its size, and the needs of its management. The controller, or whoever carries out his

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[1] Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 140.

[2] James L. Peirce, "The Planning and Control Concept," The Controller, September, 1954, p. 403.

[3] Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 142.

responsibilities should frequently review all reports required to ensure that they are really needed, as unnecessary reports are an annoyance as well as an unnecessary expense.

Once the data has been collected by means of the reports, it can be analyzed and variances from budget determined. This process is a function of the controller. In most corporations where the position of controller exists, it is his job to get the information, study and analyze it, determine variations from budget, determine reasons for variation insofar as possible, and interpret and present the data to top management. Then the taking of the necessary corrective action and following through is the job of the line operating personnel.

Some companies prepare a profit and loss budget, while others do not, and many take steps somewhat in between. The E.I. DuPont de Nemours Company, for example, plans on a certain per-cent of profit based on the capital investment in the individual enterprise, and a budget is madeup to meet this required profit.[1] The C and O Railroad on the other hand does not attempt to budget.[2] Other companies which do not have an actual profit and loss budget, keep a very close check on earnings, and relate net earnings (be-fore taxes) to shares of stock, sometimes on a basis as frequently as once per week.

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[1]Address by Mr. H.G. Boulton, Controller of International Business Machines Co. to the Navy Graduate Comptrollership Class, George Washington University

[2]Address by Mr. Roger F. Brown, Controller of the C. and O. Railroad to the Navy Graduate Controllership Class, George Washington University

Although specific profit and loss budgets may not be maintained, some sort of financial planning must take place. H. H. Scaff in Financial Planning and Long Term Forecasting states:

> Financial planning may be defined as the preparation and translation of the short and long term plans and programs of business into terms of the funds (money) needed to consummate such plans and programs, the subsequent determination of the most desirable and economical ways to acquire such funds, the control over the expenditure of the funds, and the appraisal of the results obtained from these expenditures.[1]

The Sales Budget.--The sales budget is often the same as the sales forecast. Sales budgets are prepared in different ways, as required by different businesses and the policies of management. Generally, however, estimates are prepared by the lower echelons in the sales department, modified by the judgement and experience of senior executives, and then related to economic forecasts. A common practice is to have a trend chart of sales of certain types of products and to compare these trend charts with trend charts prepared by professionals for business as a whole.

Sales are usually budgeted both by units and by dollars. The budget in dollars is not necessarily the criterion because a failure to sell the budgeted number of high profit items will not be compensated for by additional sales of low profit items. The unit sales budget is important because it reflects what must be produced or processed physically by the company during the budget period. This, of course, must be related to plant capacity and a number of other items.

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[1]Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 53.

Sales budget reports are prepared and submitted as required by individual management; usually monthly, quarterly, and year to date reports are made.

> They show a comparison of actual with budgeted dollar sales, and illustrate variance from budget in dollars and cents: (1) by product class, (2) by sales territory by product class, (3) by sales territory by salesman, (4) by principal customers."[1]

A comparison of sales of units of individual products is also made to cover the planned profit. An analysis of the variances of sales from budgeted sales will normally determine the difficulty. The fault may be with an individual salesman, or sales manager, a failure in communications, too small an advertising budget, new competition, or a host of other reasons. In any event the sales budget has acted as a control to spotlight the difficulty, and management may take the corrective action deemed necessary.

<u>The Inventory Budget</u>.--Control of inventory is a must for any business for a variety of reasons, and in large businesses this must be done by an inventory budget, or an inventory increase or decrease budget. The need for close inventory control of perishable items and those subject to quick obsolescence is obvious. Two other major reasons for control are the tying up of working capital in inventories, and the cost of storage space. The computation of required inventory brings to light any excessive inventories and raises the question of their disposition. The inventory budget will not necessarily parrot the sales budget as

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[1] Lillian Doris (ed.), <u>Corporate Treasurer's and Controller's Handbook</u> (New York: Prentice-Hall, Inc., 1951) p. 143.

inventories may be either high or low at the time the sales budget is prepared.

An inventory budget report provides a comparison of actual with budgeted inventories. To be effective as a control it must be compared with other budget reports to determine if the variances are due to sales or production performance. Sometimes the Transportation Division may be the cause of the trouble, as happens quite often in the case of integrated oil companies.[1] To be an effective control the inventory budget must be flexible.

The Production Budget.--The production budget is based on the sales and inventory budgets, and usually by items. The cost of production budget is one that receives considerable attention from top management. By the use of standards, production costs can usually be budgeted quite closely. Deviations of actual from budgeted costs as shown by the cost of production budget reports spotlights the operation or segment of the organization which apparently is falling down. The variations must be explained.

Control of production costs is essential in any company or it will soon find itself in a bad financial condition. An analysis of small business concerns which failed in 1955 made by the Wall Street Journal indicated that failure to budget and thereby control production costs was the major cause of collapse.[2]

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[1] Address by Mr. John W. Schultz, Budget Manager of the Atlantic Refining Company to the Navy Graduate Comptrollership Class, George Washington University, December 1, 1955.

[2] Wall Street Journal, October 23, 1955, p.1.

Production budgets have a collateral value in enabling a concern to maintain a uniform labor force, and avoid layoffs; no minor item today with the high cost of labor and the shortage of qualified technicians.

Direct Materials Budget.--The direct materials production budget is obtained by converting the production budgets for items into terms of the materials which must go into them. Generally speaking, use standards are applied. Provided proper direct material use standards and direct material price standards are used, the direct materials budget figures should function satisfactorily as a control for comparison of actual with budgeted costs. The device of the direct materials budget will make it apparent when excessive scrap is being made or when more than the standard amount of materials are being used because of poor engineering techniques.

Allen H. Ottman says that in addition to its regular function the direct materials budget is useful in checking the adequacy of storage space, checking the ability of vendors to supply materials, and scheduling material purchases.[1]

The Labor Budget.--Direct labor can be budgeted on the basis of proper standards. The selection of these standards, which are the basis of the labor budget is not a simple process. Heckert and Wilson say:

> The mere estimating of what the labor cost will be, while important for the coordination of operations and finance, makes no considerable contribution to the actual control of the labor costs. It is only when the procedure leads to extensive study, and inquiry into what under the circumstances, labor performances and the costs should be,

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[1]Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951) p. 122.

> that a basis is provided for control ... The use of the budget as a labor control device depends upon the extent to which it is predicated on dependable standards.[1]

Sometimes direct-indirect labor hours can be budgeted against units produced where the indirect labor can be definitely assigned to certain operations. The indirect labor must show up in the cost of goods sold in some place.

Reports of actual labor hours and costs are compared with the budgeted figures, and variances noted. If the proper standards have been used, variances indicate either inferior or superior performance of supervisors and/or foreman, unless some special labor problem has developed since the budget was prepared.

In analyzing labor costs it is necessary to determine that direct labor charges are not being charged to indirect labor in order to produce a good comparison with budget, and give the appearance of efficiency.

Selling Expense Budget.--Selling expense is an item which can easily get out of hand and radically reduce profits; it must be controlled. In order to control this expense most companies prepare a selling expense budget. These budgets vary widely among companies but if they are to function effectively there must be a definite assignment of control responsibility to individuals.[2]

Here again, actual selling expenses (by salesman, section, etc.) are compared with the budgeted figures. Whenever possible

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[1]Heckert and Wilson, Business Budgeting and Control (New York: Ronald Press Company, 1955), p. 175.

[2]Ibid., p. 303

the selling expenses should be allocated to product items. For example, some department stores charge the various small sections rent for the particular space occupied in the store, in order to equitably assign selling expense.

The selling expense budget report is the medium of obtaining the data for control purposes. The following reports are important in controlling selling expenses:

1. Summary of sales division by sales department and section.
2. Summary of sales division by expense classification.
3. Sales department by expense classification.
4. Sales departmental section by expense classification.[1]

Advertising Expense Budget.--Advertising expense must be controlled. In some businesses the budgets for advertising have become so large that they are contracted to advertising concerns. Advertising expense lends itself better to control than many other expense items, however.

Although institutional advertising must be prorated among products, most advertising programs are designed to foster the sale of a particular product and can be budgeted and charged against that item. Control of advertising expense may sometimes call for an increase in the budget in order to move the product.

The following reports should afford an effective period and year to date comparison of actual with budgeted advertising expense, and show variance in dollars and percent:

1. Summary of advertising department by expense classification
2. Summary of advertising program by individual advertising projects.

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[1]Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 145.

3. Individual advertising projects by advertising cost breakdown; for example, layout, art work, engraving, printing, space cost, mailing, and the like.[1]

Administrative Expense Budget.--Administrative expenses must be controlled just as other expenses, but they are not as susceptible to assignment of responsibility as other expenses. The assignment of administrative expense among departments and products must be done with care as some administrative expenses bear a definite relation to budgeted sales volume, such as billing, while others have little or no relationship to the budgeted sales volume. Other expenses become due and are paid only once a year, and the question of prorating over the period arises. Whenever possible, however, administrative expense should be allocated to products, in order to determine what the actual profit is on each item.

A unique system of controlling certain types of administrative expenses is practiced by the Atlantic Refining Company. The various operating elements are allowed to decide whether or not, and how much they desire in the way of staff services. They are charged as administrative expense for the staff services they use.[2]

Administrative expense budget reports are used to compare actual with budgeted administrative expense. A period and year to date comparison can be provided by the following reports:

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[1] Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York: Prentice-Hall, Inc., 1951), p. 146.

[2] Address by Mr. John M. Schultz, Budget Manager of the Atlantic Refining Company in an address to the Navy Graduate Comptrollership Class, George Washington University, December 1, 1955.

1. Summary of administrative division by administrative department and sections.
2. Summary of administrative division by expense classification.
3. Administrative department by expense classification.
4. Administrative departmental section by expense classification.[1]

Capital Expense Budget.--Most corporations find it necessary to prepare long range forecasts of capital expenditures. This is necessary in order to prevent overexpansion while ensuring that adequate facilities will be available for planned expansion needs. In this latter connection it is closely allied with the cash forecast and budget. The importance of the capital expenditures forecast depends upon the nature of the business, and the long range aims. As an example, public utilities companies must budget and forecast capital expenditures well into the future. Capital expenditure estimates must include replacement of plant and equipment as well as expansion; it is for this reason that it must be planned well into the future in order to assure that the cash is available or the necessary financing arrangements have been made.

The capital expenditure budget is usually made for a year in advance and is the most inflexible of the budgets used in business and industry. Quite often the budget is broken down into individual projects for purposes of better control. By classifying by projects management can better judge the worth of each project.

In addition to the control inherent in the establishment of limits for specific and some blanket capital expenditures in the budget, further control is provided for in most companies by requiring that a capital expenditure request be submitted and

[1]Lillian Doris (ed.), Corporate Treasurer's and Controller's Handbook (New York. Prentice-Hall, Inc., 1951), p. 146

1. Summary of appropriations by divisions or organizational departments and functions.
2. Summary of appropriations by divisions by expense classification.
3. Administrative department by expense classification.
4. Administrative department divisions by expense classification.[1]

<u>Capital Outlays Budget</u>.--Most corporations find it necessary to prepare long range forecasts of capital expenditures. This is necessary in order to prevent overexpansion while assuring that adequate facilities will be available for planned expansion. In this latter connection it is closely allied with the sales forecast and budget. The importance of the capital expenditures budget depends upon the nature of the business, and the length of time. As an example, public utility companies must budget and forecast capital expenditures well into the future. Capital expenditures must include replacement of plant equipment as well as expansion; it is for this reason that it must be planned well into the future in order to assure that the cash is available or the necessary financing arrangements have been made.

The capital expenditures budget is usually made for a [illegible] the average [illegible] the useful life of the assets used in the business and inventory [illegible] often are treated as lump [illegible] individual projects. For purposes of better control, [illegible] an estimate [illegible] and [illegible] the cost of the project.

In addition to the control afforded by the establishment of limits for spending and some general control expenditures [illegible] by project, overages are not to be incurred [illegible] requiring that a special authorization request be submitted and

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[1] William Travis Jerome, <u>Corporate Planning [illegible]</u> (New York: [illegible], 19[illegible]), p. [illegible]

approved for every capital expenditure over a certain amount even though the expenditure is provided for in the budget. This permits a re-evaluation of the value of the expenditure again at the time it is made.

A capital expense budget report is the device used to effect a comparison of actual expenditures made for capital investment for comparison against the budget. This can be done for any time period desired by management. These reports are often used to show the progress (percent completion) of various projects to top management as it may be desirable to give added emphasis to some, or to slow down on others.

The Cash Budget.--Like the capital investment budget, the cash budget is the short range, firm plan which is based on a long term forecast. The cash budget summarizes the estimated cash income and the estimated cash disbursements over the budget period. The cash budget is important in all companies because it represents the liquid working capital which is available to meet current obligations. Without a budget for cash, it's control would be extremely difficult. One factor which makes it hard to budget is irregular disbursements, such as prepayment of rent, insurance premiums, etc. In the case of a company which is rapidly expanding sales but is short of working capital the cash budget shows the necessity of bank borrowings, or the possible need to factor accounts receivable.

The cash budget report provides a period comparison of actual cash income and expenditures with those budgeted.

The above budgets which are used as controls in business

have been briefly described as they are the most common, however the budgets used by a business will depend upon the nature of the business and the needs of its management. Each of the above described budgets is general in nature; subsidiary budgets by division, group, product, sales branch, etc. will be maintained in many large companies. Other budgets which might be used are: cost of sales budgets, machine hour budgets, utilities budgets, indirect supplies budgets, general factory overhead budgets, "other" operating income and expense budgets, nonoperating income and expense budgets, and others peculiar to certain companies.

CHAPTER III

BUDGETS AS CONTROLS IN GOVERNMENT

There are many governmental budgets: national, state, county, and municipal, but only the budget of the federal government of the United States will be discussed in this paper. The federal budget is of great importance to all of us in many ways. It provides for the many essential services which we tend to take for granted, such as national defense which is essential to our very existence, pure food and drug enforcement, the Federal Courts, the Department of Agriculture, the Immigration Service, and thousands upon thousands of other services upon which our welfare, both individually and as a nation depend. It is vital to us all, also, in the tremendous economic impact which it has; it can be used to cause depressions, or to act as a balance to offset changes in the private economy to produce the most healthy economic conditions, accordingly as it is imprudently or wisely formulated and executed. Inasmuch as all operations require money, the federal budget really represents the operating plan of our national government; in this sense it meets the business definition of a budget given in Chapter I, namely, that a budget is a coordinated operating plan expressed in financial terms.

However, the similarity between the federal budget and those of business seems to stop at about this point. Just as the objectives of business and government are different, we must

expect their budgets to be different. W. Rautenstrauch points out that:

> There is a fundamental difference between governmental and industrial budgets, namely that governments first estimate their expenses and then raise taxes or contract loans to cover them, while businesses must first estimate their possible income, or funds available, and only then determine their most effective allocation and use in operating the business.[1]

In discussing business budgets we described several different types of budgets, all of which are used by the same business. The federal budget is one huge document, an executive budget, which is submitted once a year to Congress. It is a request for appropriations to cover the operations of the government for a one year period. The complete process of budget formulation and execution, including the legislative steps is a complicated and lengthy process which will not be described here, but will be touched on only as it relates to control.

The enormity and complexity of the federal budget can be better understood when we realize, that just to prepare the budget for the defense department alone for one year cost thirty million dollars.[2] F.C. Mosher, who made a detailed study of budget procedures in the Department of Defense states:

> The observer aspiring to understand and describe budgeting in the military establishment today can hardly avoid the risks of oversimplification, overgeneralizing, and downright inaccuracy. The process is so large in overall dimensions, so intricate in details, and so complex as to defy comprehension by a single mind.[3]

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[1]W. Rautenstrauch, Budgetary Control (New York: Funk and Wagnalls, 1950), p. 4.

[2]Paul Haas, "Thirty Million Dollars Just to Draft the Budget," The Controller, February, 1954, p. 57.

[3]F.C. Mosher, Program Budgeting (Chicago: Public Administration Service, 1954), p. 124.

Control as relates to the federal budget is a rather different thing than the control exercised in business as discussed in the previous chapter. In business the basic idea of budgets is to control operations, to promote efficiency, and increase profits. Control with regard to the federal budget is pretty much limited to control over expenditures in the sense of providing, or not providing the money for a particular program or part thereof. The business budget that bears the most resemblance to the federal budget is the capital expenditures budget. Control in relation to the federal budget is generally considered to be exercised in the formulation and appropriation processes by eliminating, reducing, or increasing funds for specific programs.

Control over expenditures as such, is further limited by the procedures whereby appropriations are held over from previous years. Other restrictions on proper control is the fact that the federal budget looks ahead for only one year and lacks flexibility. The federal budget does not lend itself to making a comparison of figures to determine efficiency of operation.

Control of the budget is and has been the source of a tug of war between the legislative and executive branches. The control is desired to foster or kill off particular programs, and the elimination of nonessential or wasteful expenditures, however the question of power and prestige has probably been a more potent factor than the other two. Control of the federal budget is exercised in one form or another by the Congress, the President, the Bureau of the Budget (in the name of the President), and the departments and agencies for whom the money is budgeted.

Congress is vested with the authority to control the public purse, and is the authority for all appropriations. It is generally conceded by most students of the subject that the efforts of Congress to control the operations of the executive by means of the budget have been ineffective. The efforts of Congress to promote economy and efficiency via the budgetary process have also come to nought. Congress has been unable to exercise any effective control because of the nature and ineffectiveness of the present budgetary process. Appropriations for expenditures are not related to revenue in the Congressional procedure, although this is done in the President's budget message. The establishment of the Executive Budget was a great step forward and Harold D. Smith, a former budget director states, "With the development of an executive budget, and executive budget management, legislative controls have become more effective."[1] The requirement of the presentation of a "program budget" by the Department of Defense also should have increased legislative control. However, because of the processes and the attitudes of most congressmen these steps have not been utilized to advantage in exercising control.

One reason Congress has been ineffective in exercising control is its refusal to have a real program budget and evaluate programs against cost and results. Even though Congress did pass a bill requiring the Department of Defense to submit a program budget, it has not been properly used, and the military departments are required to present back-up material so that Congressmen can

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[1] Harold D. Smith, "The Budget and Executive Management," <u>Public Administration Review</u>, Summer, 1944, p. 187.

evaluate on the basis of minutiae or their own local interests. The questions of whether a powder plant is to be built in a certain locality, or the number of secretaries in an agency appears to be of more interest than matters of real policy which should be judged by the Congress.

Another reason Congress cannot exercise control is the procedure which denies most congressmen any voice in the appropriation process whatever. All the hearings on appropriations are held by the subcommittees. Even the whole Appropriations Committee considers bills superficially and usually sends them to the floor as presented. The average uninformed congressman has no opportunity to know any of the details of an appropriation. What control is exercised is exercised by the chairman of the subcommittee, who by virtue of his position is the only member with the opportunity to do so.

> The Congress attempts to exercise budgetary control over future executive actions by highly specific appropriations, committee reports, and requiring detailed estimates of expenditures.[1]

These attempts at control are not really control at all, but attempts to keep control from the executive branch and serve mainly to create additional work and expense.

Congressional control of the budget after enactment is not easy. The money is available to the executive department for the purposes specified, and it is free to go ahead and spend the money. The only control retained by Congress after the

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[1] Arthur Smithies, The Budgetary Process in the United States (New York: McGraw-Hill Book Company, Inc., 1955), p. 138

appropriations have been made is that exercised by the General Accounting Office under the Comptroller General, an agency of Congress. The Comptroller General is the final settler of all claims against the government. His control is limited to refusal to pay claims for expenditures which he rules were not within the intent of the Congress (legality.) Arthur Smithies has this to say in regard to the effect of this control:

> Whether the central settlement of accounts in fact produces economy is a highly debatable and much debated question. It cannot be assumed that every saving accomplished by the Comptroller General would not have been achieved had main responsibility been reposed in the departments concerned. And the time and effort involved in satisfying the Comptroller General's requirements must be set against those savings.[1]

The expenditure committees of Congress have also proven to be ineffective insofar as control is concerned. The major reason for this is that they are completely isolated from the appropriation committees. They have pretty much limited themselves to occasionally bringing to light something good for publicity, such as discovering how many oyster forks the Navy has on hand.

The control exercised on the federal budget by the President and the Bureau of the Budget will be discussed together as the Bureau of the Budget is in the Executive Office of the President and acts in his name. Only the most important items are referred to the President himself. Probably his most important function in regard to the budget is to weigh it's effect upon the

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[1]Arthur Smithies, The Budgetary Process in the United States (New York: McGraw-Hill Book Company, Inc., 1955), p. 152.

national economy with the advice of the Council of Economic Advisors.

For many years the President had little control over the budget, but the establishment of the Presidential (executive) budget put much more power in his hands. Requests of individual departments and agencies for appropriations are now submitted to the Bureau of the Budget and incorporated into the executive budget. In the process all the requests for funds are thoroughly reviewed, with some being reduced and others eliminated. This enables the President to control programs to the extent he desires.

After the appropriations have been made the President has a further control in the apportionment system. Under this system, established by law in 1950, the President may require the apportionment of funds over the budget period and may also require departments to hold certain funds as reserves, which in many cases they may not be allowed to spend at all. Here again, the control is simply one to limit expenditures and promotes efficiency only in the sense that programs proven not needed or not desirable can be dropped.

The power wielded by the Bureau of the Budget in both the formulation and apportionment processes is tremendous. All appropriation requests are challenged and must be justified in the Bureau of the Budget. According to the Deputy Comptroller of the Navy, the final decision of the Bureau of the Budget is seldom challenged by the executive departments. In a period of five years the Navy Department took only one issue to the President.

In actual practice close liaison is maintained with the Bureau of the Budget in preparing appropriation requests to ensure that they will not be challenged when reviewed.[1]

Some small flexibility is allowed the departments and subdivisions of departments in that appropriations may be shifted from one item to another to meet a changing need, but any request for use of reserves must be justified to the Bureau of the Budget. Generally a request for the use of reserves for a particular project involves a review of the entire related budget for that department.[2]

As with Congress, the control exercised with the budget by the President and the Bureau of the Budget is limited pretty much to controlling expenditures, and little is accomplished toward promoting efficiency in the process.

The budget is used as a control to some extent within the individual departments. Programs are established and the funds necessary to support them computed. Justification of the request for funds must be made. Within the Department of Defense all requests for appropriations and for apportionments receive several reviews at various levels, and the appropriate personnel are present to defend their projects. Many large cuts are made before the department requests ever reach the Bureau of the Budget.

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[1]Address by Rear Admiral Clexton, Deputy Comptroller of the Department of the Navy, to the Navy Graduate Comptrollership Class, George Washington University.

[2]Address by Mr. Simmons, Budget Section, Bureau of Ships, to the Navy Graduate Comptrollership Class, George Washington University.

No discussion of control as related to the federal budget would be complete without some mention of comptrollership. In a memorandum written November 13, 1950, the Secretary of the Navy stated:

> The comptrollership provisions of the National Security Act Amendments of 1949 and its statutory history, as well as the Hoover Commission hearings which led ultimately to the Security Act Amendments show that it was the intent of Congress to have the fiscal system of the military departments resemble that of private business as closely as the fundamental differences between them would permit.[1]

F. C. Mosher, in his study of budgeting in the military department says:

> The controller concept in business envisages a company officer who is part of top management at a level above operating elements of the organization and having direct access to the principal manager. All four Defense Department Comptrollers follow this pattern faithfully.[2]

Although the Defense Department Comptrollers fit into the organizational pattern in much the same way as controllers in private industry, the amount and manner of control they exercise is different. Their job is the review of budget requests based on the approved programs and recommending cuts based on past experience and a knowledge of what the total amount of money which will be approved will probably be. Hearings are held with the top operational executives present, and the decision as to whether the cuts will be made or not rests with the latter.

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[1]Memorandum from the Hon. Francis P. Matthews, Secretary of the Navy to the Bureaus, Offices, and Boards of the Navy Department, November 13, 1950.

[2]F.C. Mosher, Program Budgeting (Chicago: Public Administration Service, 1954), p. 218.

Here again, the function seems to be one of limiting amounts of money for specific purposes; little is done in the field of promoting efficiency.

CHAPTER IV

A SUMMARY AND COMPARISON

We have seen in Chapter II how budgets function as controls in business, and in Chapter III how the federal budget functions as a control in government. Large dissimilarities have been noted.

In business many detailed budgets are prepared for different aspects of the operation. The actual costs or expenditures are periodically compared with the budgeted costs or expenditures and variances noted. The reasons for the variances are then determined and the management takes whatever corrective action may be necessary. It can be seen that in this way the operations of the company are closely watched and controlled. The budget is the tool of control.

In looking into the operation of the federal budget, on the other hand, we find that control means something else. The control is not much more than the limitation of funds; the budget however is still the tool of control for in it are contained all the operations of the government for the budget period. The program budget, as used in the Department of Defense, and to some extent in the Department of Agriculture, makes it possible to exercise this control in a more intelligent fashion but we find the Congress reluctant to use it. The use of the budget as a control

in government as it is used in industry is restricted pretty much to governmental corporations, and to lower echelons in the other departments which function on an industrial basis, such as the Overhaul and Repair Department of a Naval Air Station, or a Naval Shipyard.

However, before being too critical of the seeming lack of control in the use of the federal budget, we must realize the many differences between government operations and those of business. F. C. Mosher says:

> Controller's grew up to meet the demands of increasing complexity and bigness in private enterprise. In that realm they have proven useful....The Defense Organization's functions are public and governmental; the processes and factors entering into decisions concerning it are political; the measurement of performance in terms of objectives in peacetime is political, and in wartime rests upon military success or failure, ultimately upon national survival.[1]

The promotion of economy and efficiency in governmental operations must take place at executive levels within the operating departments. In this sense the federal budget itself is not a tool of control. Individual budgets for industrial type enterprises can be used in the same manner as in private business, but there are many difficulties which stem from the basic philosophy and purpose of government endeavor. For example, at a shipyard it may be good judgement to maintain a heavy capital investment in machines which are seldom used, but must be available in case of emergency. There are others and I guess we must conclude also,

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[1]F.C. Mosher, Program Budgeting (Chicago: Public Administration Service, 1954), p. 219

that despite conscientious personnel, control is never so effective as when there is a dollars and cents profit motive as there is in private business.

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